

## **CHAPTER 10: PROJECT CONSTRUCTION**

### **10.1 INTRODUCTION**

Management of construction is the borrower's responsibility. However, the Agency will monitor construction to ensure that it takes place according to the project plans and specifications. Consequently, the Agency plays an active oversight role in the construction process, from concurring in the construction contract to performing progress inspections and reviewing final construction documents. This chapter describes the Agency's procedures for carrying out these responsibilities. It summarizes the requirements established under RD Instruction 1924-A, Planning and Performing Construction and Other Development and RD Instruction 1924-C, Planning and Performing Site development Work but does not substitute for a thorough understanding of those instructions.

The chapter is organized as follows:

- Section 1 describes construction requirements including construction standards, contracting methods, contractor requirements, and cost certification.
- Section 2 describes the contracting procedures from the invitation to bid through the pre-construction conference and the Notice to Proceed.
- Section 3 describes the Agency's responsibilities during construction including inspections, concurrence in change orders and contractor payments, and contract close-out.

### **10.2 OVERVIEW OF THE AGENCY'S ROLE IN THE CONSTRUCTION PROCESS**

The Agency's involvement in the construction process begins with the submission of the initial application. The State Architect reviews all construction documents, beginning with the preliminary plans and specifications and concluding with the final plans prior to loan approval. The State Architect must concur in the project design, project plans and specifications and detailed cost estimates before the loan is closed or construction begins (whichever comes first). The State Architect will also consult with the State Environmental Coordinator regarding any mitigation measures required by the environmental review which may affect project plans and specifications.

The Agency concurs in the borrower's selection of a contractor and in the construction contract. The Agency will also want a pre-construction conference to be held, as described in Section 10.11.

During construction, the Agency assumes an oversight role, performing inspections and concurring in change orders and contractor payments. The Agency also performs a final inspection before contract close-out.

(Note that the Agency's role in construction oversight does not diminish the role of the project architect hired by the borrower. The project architect is responsible for ensuring that the

project is constructed according to the plans and specifications. The architect's responsibilities include regular inspections, payment requests, change orders, change directives, and all other oversight of construction activities.)

### **10.3 CONSTRUCTION FINANCING**

There are two methods of financing construction: interim financing and multiple advances.

- If the borrower obtains interim financing, an interim lender provides the funds for construction and the Agency does not close its loan until after construction. The Agency prefers to use interim financing whenever possible.
- If the borrower obtains multiple advances, the Agency advances funds to the borrower to pay for construction as the work progresses. If multiple advances are used, the borrower must document that interim financing is not available at suitable rates or terms.

These methods are described in Chapters 5 and 6. Regardless of the method used, the Agency will assist in supervising the construction process as described in this chapter.

### **10.4 IDENTIFY-OF-INTEREST (IOI) RELATIONSHIPS**

If any the construction involves an IOI relationship, the following steps must be taken:

- The owner must disclose the IOI relationship to the Agency.
- The contract must have prior Agency approval.
- The costs of the contract must compare favorably with competitively bid, non-IOI costs.
- The contractor must certify all costs in accordance with cost certification methods described in Section 10.8.

## **SECTION 1: CONSTRUCTION REQUIREMENTS**

### **10.5 CONSTRUCTION STANDARDS**

Construction standards are prescribed in RD Instruction 1924-A, Planning and Performing Construction and Other Development. Projects must be designed to meet:

- The development standard adopted by the Agency in the state where the project is located;
- Agency thermal performance standards;

- Applicable local or state laws, ordinances, codes and regulations; and
- Requirements indicated in Appendices C through F of HUD Handbook 4810.1 “Minimum Property Standards”.

Land and site development must meet the standards and requirements in RD Instruction 1924-C, Planning and Performing Site Development Work. These requirements are discussed in Chapter 3. The project architect must certify to such compliance, as described in RD Instruction 1924-A, Planning and Performing Construction and Other Development and RD Instruction 1924-C, Planning and Performing Site Development Work, prior to Agency approval of the loan. *Form RD 1924-25, Plan Certification* may be used for this purpose. In addition, the project architect must also certify that the project has been designed in accordance with all applicable accessibility standards and guidelines. These standards may include, but not be limited to, the Uniformed Federal Accessibility Standards (UFAS), the Fair Housing Act Accessibility Guidelines (FHA/AG), the Americans with Disabilities Act Accessibility Guidelines (ADA/AG), and any applicable State or local requirements.

## **10.6 METHODS OF CONTRACTING**

There are three methods of contracting for the construction of multi-family housing projects — competitive bidding, negotiated contracts, and owner-builder contracts. Any of these methods could involve an IOI relationship.

### **A. Competitive Bid**

All construction contracts must be awarded by competitive bid unless an exception is granted for either a negotiated contract or owner-builder method of construction as described in paragraphs B and C below. Contracting methods other than competitive bidding require a waiver from the Agency. Exhibit 10-1 describes the items required in a request for a waiver.

For competitive bidding, the borrower provides public notice inviting contractors to submit a bid. Contracts are selected based on cost and are awarded to the lowest responsible bidder.

Both costs and the contractor must be concurred in by the Agency. The contractor must be licensed as required by the State and may not be on the list of debarred contractors. The contractor must provide a performance and payment bond, or an acceptable alternative as described in RD Instruction 1924-A, Planning and Performing Construction and Other Development.

The competitive bidding process is discussed further in paragraph 10.9.

## B. Negotiated Contracts

Borrowers may request a waiver from competitive bidding if they prefer to use a specific contractor or if the competitive bidding process does not yield an acceptable bid. Negotiated contracts are not acceptable without prior approval of the Agency. The State Director may issue the waiver if the following conditions are met:

### Competitive Bids and Negotiated Contracts

At times of high construction activity, when construction prices tend to be higher, negotiated bids may provide lower costs. At times of low construction activity, competitive bidding is more likely to yield lower costs.

- The cost under the negotiated contract compares favorably with similar and recent construction in the area.
- The proposed contractor is a reliable contractor who will comply with the requirements of RD Instruction 1924-A, Planning and Performing Construction and Other Development.
- The reasons for requesting the waiver from bidding are documented.

The information required for a written request to waive competitive bid requirements is provided in Exhibit 10-1.

## C. Owner-Builder [RD Instruction 1924.13(e)(2)]

Owner-builder contracts for construction can be used only with prior approval of the Agency. This condition applies to projects where the entity proposed for general contractor for the project is identical to the borrower/owner entity. Owner-builders must be qualified to do the construction work and must show that they are licensed contractors within the state where the project is located.

Before approving a borrower's request for an owner/builder contractor arrangement, the Loan Originator and the State Architect/Engineer will review the borrower's written request, drawings, specifications, and cost estimates, to determine whether the arrangement is in the best interest of all parties. All borrowers with owner/builder construction situations are required to execute the same contract as under other contracting arrangement but must also certify the final construction costs as described in paragraph 10.8. Any savings (as documented by the cost certification process) are returned to the government.

The information to be included in the borrower's written request is provided in Exhibit 10-1.

**Exhibit 10-1****Information to be Included in Borrower's Request  
to Waive Competitive Bidding Requirement**

- A resume indicating the proposed contractor's history, ability, and experience.
- Financial statements from the current year and the prior year showing the proposed contractor's payment status and any existing liabilities.
- A credit report attesting to the contractor's credit standing.
- A listing of trade references that could be contacted to confirm the contractor's experience and good standing.
- Statements from others for whom the contractor has performed work.
- A cost item breakdown that also estimates the total development cost of the project.
- A description of the construction accounting system that will be used to maintain costs of the project.
- Permission for the Agency to have access to all books and records needed to conduct an audit

**10.7 CONTRACTOR REQUIREMENTS**

The Agency must ensure that the contractor meets the requirements described below.

**A. Debarment and Suspensions**

Prior to executing a contract, contractors must sign certification statements indicating that they are not currently debarred or suspended from participating in federally funded programs. The certification statement is included on *Form AD-1048, Certification Regarding Debarment, Suspension, Ineligibility, and Voluntary Exclusion*. Failure to submit the certification is grounds to reject the bid. It is the Agency's responsibility to check the list of debarred and suspended contractors to make sure the contractor is not listed there (even if the contractor has submitted the certification).

**B. Insurance**

The contractor must have property and liability insurance for construction to protect the borrower and contractor from a variety of losses. The construction contract must not become valid until proof of insurance is obtained. The amount of coverage and the other insurance provisions of the coverage must be in accordance with the project's plans and specifications.

**C. Payment and Performance Bonds**

Payment and performance bonds covering the contractors' work must be executed prior to the start of any construction. The bonds must each have a face value of 100

percent of the construction contract. These surety bonds must only be obtained from a corporate bonding company listed on the current Department of Treasury Circular 570 (published annually in the Federal Register), as holding a certificate of authority as an acceptable surety on federal bonds, and as legally doing business in the State where the project is located.

If interim financing is involved, the interim lender may waive the bonding requirement. This is to be done in writing and to be attached to the contract documents.

An alternative to the bonding requirement is a letter of credit. Requirements for letters of credit are discussed in paragraph D, below.

#### **D. Letters Of Credit**

In lieu of payment and performance bonds, the lender (or in the case of multiple advances, the Agency) may accept an unconditional and irrevocable letter of credit issued by another lending institution to secure the completion of construction. The letter of credit must equal the amount of the construction contract and must remain in effect until the date of final acceptance of work by the owner and the lender. In addition, the letter of credit must stipulate that the lending institution that issued the letter of credit, upon written notification by the owner or lender (or the Agency) of the contractor's failure to perform under the terms of the contract, will provide payment up to the amount of the contract to satisfy all prior debts incurred by the contractor in performing the contract and all funds necessary to complete the work.

An irrevocable Letter of Credit issued by a bank or other approved financial institution must meet strict credit quality requirements (see Exhibit 10-2 for credit quality requirements) and be for 100 percent of the original principal amount of the combination loan.

Further requirements for letters of credit include:

- The issuing institution must not be an affiliate of the lender, unless it has an acceptable rating from an approved rating agency, which is not an affiliate of the lender.
- Federal Home Loan District Bank enhancement of a member bank letter of credit is an acceptable method for meeting Agency credit standards.
- The Rural Housing Service (RHS), USDA, must be named as the sole beneficiary.
- The term must be a minimum of one year.
- The form of the letter of credit and the sight draft must be reviewed and approved by the Agency.

**Exhibit 10-2**  
**Credit Quality Requirements for Letters of Credit**

<b>Rating Agency</b>	<b>Type of Collateral</b>	<b>Rating</b>
Thomson's Bankwatch	N/A	"B" or better
S&P	Long-term senior debt, if rated, or long-term bank deposit	"A" or better
Moody's	Long-term senior debt, if rated, or long-term bank deposit	"A" or better

**E. Warranties**

At the time of the final inspection, the contractor must execute *Form RD 1924-19, Builder's Warranty*, providing a 12-month warranty on work performed and materials supplied.

**F. Compliance with Civil Rights Requirements**

The contractors must comply with all applicable civil rights requirements. A partial list includes:

- Architectural Barriers Act (ABA)
- Section 504 of the Rehabilitation Act of 1973 and the Uniform Federal Accessibility Standard
- Americans with Disabilities Act (ADA) and the Americans with Disabilities Act Accessibility Guidelines
- Fair Housing Act (FHA) and the Fair Housing Act Accessibility Guidelines
- Executive Order 11246
- Any State or Local Requirements

**10.8 COST CERTIFICATION**

In certain cases the borrower, the contractor, and any subcontractors must each provide a certification of the actual costs of construction. Appropriate circumstances for cost certification include:

- All IOI construction situations; and
- Other cases deemed appropriate by the Agency. For example, the Agency may request cost certifications for all projects to assist in cost tracking and help determine if future bids are reasonable. Or, the Agency may want to scrutinize particular

contractors who work on significant numbers of Agency projects or who have shown questionable performance in the past.

The costs must be reported on *Form RD 1924-13, Estimate and Certificate of Actual Cost* and this form must be audited by a licensed CPA in accordance with Government Auditing Standards. This function may be contracted out by the Agency.

Cost certification is an ongoing process for Agency staff, beginning with the preliminary estimate of cost provided in the initial application through the final payment to the contractor and payment of any other obligations. Guidance on processing cost certifications can be found on *Form RD 1924-26, Cost Certification Worksheet* and Exhibit M of 1924-A, *Seven Steps to Cost Certification*.

A short summary of the cost certification process is provided in Exhibit 10-3.

### Exhibit 10-3

#### Overview of the Cost Certification Process

**Pre-application.** Loan processing staff compare the applicant's preliminary estimate of cost to historic costs and Marshall and Swift and discuss any concerns with the applicant.

**Application.** Loan processing staff review the applicant's estimate of costs provided on *Form RD 1924-13 Estimate and Certificate of Actual Cost* and make sure that previous concerns were addressed.

**Construction.** Loan processing staff review requests for payment and change orders to check arithmetic and verify that totals do not exceed estimates. They also check the project architect's concurrence with the payment request.

**Contract Close-out.** Loan processing staff review the final payment request and the cost certification provided on *Form RD 1924-13, Estimate and Certificate of Actual Cost* and confirm the project architect's concurrence.



## **SECTION 2: CONTRACTING PROCEDURES**

### **10.9 COMPETITIVE BIDDING PROCEDURES**

The borrower is responsible for following proper bidding procedures. Generally, the project architect oversees the bid invitation and selection process. The Agency serves only in an oversight role to ensure that proper bidding procedures are followed.

The purpose of competitive bidding is to obtain acceptable construction services for the lowest costs possible. To be successful, the competitive process must be fair. Conditions must not be established which would give preference to a specific bidder or type of bidder. If no acceptable bids are received, the borrower may re-bid the contract or proceed to a negotiated bid, with Agency approval.

#### **A. Contents of the Bidding Package**

For competitive bids, the project architect prepares bid documents to be distributed in the bidding package. The bidding package must include the items listed below. (For a complete discussion of the content of these documents, see RD Instruction 1924-A, Planning and Performance Construction and Other Development, Guide 1.)

- Advertisement for Bidders — RD Instruction 1924 A, Planning and Performing Construction and Other Development, Guide 1, Attachment 1;
- Information for Bidders — AIA document G701-1987 and Agency Addendum (RD Instruction 1924 A, Planning and Performing Construction and Other Development, Guide 1, Attachment 2);
- Bid Form — RD Instruction 1924 A, Planning and Performing Construction and Other Development, Guide 1, Attachment 3;
- Bid Bond Form — RD Instruction 1924 A, Planning and Performing Construction and Other Development, Guide 1, Attachment 4;
- Plans and specifications; and
- *Form RD 400-6, Compliance Statement.*

#### **B. Distribution of the Bidding Packages**

The invitation to bid must be distributed to all interested parties. The borrower may send the invitation directly to specific contractors from whom bids are desired, but public notice is always required so that other contractors have an opportunity to bid.

## 10.10 AGENCY CONCURRENCE IN THE CONTRACT

A contract is signed and concurred in by the State Director (or his/her delegate). The Agency is not a party to the contract but still must ensure that the borrower and the contractor comply with regulatory requirements.

### A. Review of the Bid

The borrower must submit the following for Agency review:

- A bid summary that shows the project architect's estimate of costs and all bids submitted;
- A revised cost breakdown on *Form RD 1924-13, Estimate and Certificate of Actual Cost*;
- The project architect's recommendation (If the project architect does not recommend that the bid be awarded to the lowest bidder, the recommendation must include a justification for an award to a higher bidder); and
- Documentation of the borrower's decision — i.e., a copy of the bid selected.

Loan processing staff should review the bid documentation to confirm the following items.

- The selected bid is properly completed including the bid bond.
- Based on the *Form RD 1924-13, Estimate and Certificate of Actual Cost*, there is enough money to cover the costs.
- The project architect has provided sufficient justification for the bid selection.

After these items have been reviewed, the Agency should advise the borrower in writing of any problems or of its concurrence with the bid award.

### B. Contract Documents

The borrower must use the construction contract form published by the American Institute of Architects (AIA Document A-101) with the Agency-approved amendment (RD Instruction 1924-A, Planning and Performing Construction and Other Development, Guide 1, Attachment 6). Other contract documents, acceptable to the loan approval official and containing the requirements of RD Instruction 1901-E, may be used provided they are customarily used in the area and protect the interest of the borrower and the Government with respect to compliance with items such as the drawings, specifications, payments for work, inspections, completion, nondiscrimination in construction work and acceptance of the work. If needed, the OGC will be consulted. The United States will not become a party to a construction contract or incur any liability under it.

The construction contract must contain, in its entirety, the nondiscrimination language required by Executive Order 11246 and also by regulations issued by DOL. That language may be found in the DOL regulations at 41 CFR 60 [§60-1.4(b)] and on pages 2 through 4 of *Form RD 1924-6, Construction Contract*.

Loan processing staff should maintain a file with all documents related to construction. A complete list of contract documents is provided in Exhibit 10-4. See RD Instruction 1924-A, Planning and Performing Construction and Other Development for more guidance on contract documents (1924.13(e)(1)(ii) and 1924-A, Guide 1).

#### **Exhibit 10-4**

#### **Contract Documents**

- Advertisement for Bidders (RD Instruction 1924-A, Guide 1, **Attachment 1**)
- Instructions for Bidders (AIA Document A701-1997)
- Supplementary Instructions for Bidders (RD Instruction 1924-A, Guide 1, **Attachment 2**)
- Bid (RD Instruction 1924-A, Guide 1, **Attachment 3**)
- Bid Bond (RD Instruction 1924-A, Guide 1, **Attachment 4**)
- Compliance Statement (*Form RD 400-6*)
- Notice of Award (RD Instruction 1924-A, Guide 1, **Attachment 5**)
- Standard Form of Agreement between Owner and Contractor (Construction Contract) (AIA Document A101-1997)
- Supplement to Standard form of Agreement between Owner and Contractor (RD Instruction 1924-A, Guide 1, **Attachment 6**)
- Certificate of Owner's Attorney (RD Instruction 1924-A, Guide 1, **Attachment 7**)
- Contract Concurrence (RD Instruction 1924-A, Guide 1, **Attachment 8**)
- Payment Bond (RD Instruction 1924-A, Exhibit F)
- Performance Bond (RD Instruction 1924-A, Exhibit G)
- Notice to Proceed (RD Instruction 1924-A, Guide 1, **Attachment 9**)
- General Conditions of the Construction Contract (AIA Document A201-1997)
- Supplemental General Conditions (RD Instruction 1924-A, Guide 1, **Attachment 10**)
- Identity of Interest Disclosure Certificate (*Form RD 1944-30*)
- Identity of Interest Qualification (*Form RD 1944-31*)
- Drawings and Specifications
- Contract Change Order (*Form RD 1924-7* or equivalent)

### Exhibit 10-4

#### Contract Documents

- Partial Pay Estimate (*Form RD 1924-18*), Application and Certificate for Payment (AIA Document G702-1992), or equivalent
- Labor Standards Provisions, only for projects subject to Davis-Bacon (RD Instruction 1940-C, Exhibit A)
- Wage Determinations (Department of Labor)
- Partial Payment Estimate Form (*Form RD 1924-18* or equivalent)
- Builder's Warranty (*Form RD 1924-19* or equivalent)

#### 10.11 PRE-CONSTRUCTION CONFERENCE

Once the contract is awarded and the contracts are signed, all interested parties must attend a pre-construction conference. The conference serves to avoid conflicts later in the construction process by clarifying arrangements and expectations in advance. *Form RD 1924-16, Record of Pre-construction Conference* or an industry equivalent may be used as a guide for an agenda.

The pre-construction conference should include the borrower, contractor, architect, lender representatives (if interim financing was obtained), and an Agency representative (if possible). The project architect should lead this meeting. It should cover, at a minimum, the following items:

- Responsibilities of all parties, including the contractor, the Agency, and the borrower;
- The work to be undertaken;
- Mitigation measures required by the environmental review;
- Procedures to be used for inspection, change orders, and payment requests;
- Time frames for starting and completing work;
- Requests for extending contract times;
- The contract agreement and any subcontracts;
- Grievance procedures; and
- Close-out procedures.

**10.12 NOTICE TO PROCEED**

The Notice to Proceed establishes the contractor's permission to proceed with construction. It gives the contractor permission to go in the borrower's land and begin work and it identifies the start date for the time period of the contract. It is issued by the borrower after the contract has been executed and the pre-construction conference has concluded. It is signed by the borrower and the contractor. The Notice to Proceed should not be issued until the Agency loan is closed (for multiple advances) or the interim lender has concurred (for interim financing).

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## SECTION 3: CONSTRUCTION OVERSIGHT

### 10.13 PROGRESS INSPECTIONS

The borrower maintains full responsibility for the quality of construction; however, the Agency must still take steps to protect the value of its investment. Consequently, the Agency must conduct periodic progress inspections to ensure that work is proceeding as planned. These inspections must be performed by persons with experience conducting Agency inspections.

#### A. Timing of Inspections

Inspections must take place prior to authorization of partial payments, normally at least monthly. In addition, the following three inspections must take place for each building:

- The initial inspection must be made just prior to or during the placement of concrete footings or monolithic footings and floor slabs.
- Another inspection must be made when the building is enclosed, structural members are still exposed, roughing in for heating, plumbing, and electrical work is in place and visible, and wall insulation and vapor barriers are installed. Customarily, this is prior to installation of brick veneer or any interior finish which could include lath, wallboard and finish flooring.
- The final inspection must be made when all on-site and off-site development has been completed and the structure is ready for occupancy for its intended use.

#### Who Performs Inspections?

Several parties have an interest in the satisfactory completion of project construction and, therefore, should conduct inspections.

- The project architect has the primary responsibility for performing regular inspections. These inspections should take place at least monthly and serve to document partial payment requests.
- An Agency representative with sufficient knowledge of construction should also inspect the property on a monthly basis. It is good practice for the Agency architect to coordinate with the project architect to perform joint inspections and to time these inspections with partial payment requests.
- The interim lender (if there is one) is also encouraged to make inspections of the property.

#### B. Inspection Procedures

Actual construction work needs to be inspected to determine and verify that terms and conditions of the construction contract are met. The project plans and specifications signed by all parties are used to judge the acceptability of the work. Items that do not meet these standards must be either removed, corrected, or in some cases, accepted with an adjusted price.

The inspector may use *Form RD 1924-12, Inspection Report* or its equivalent.

- The inspection report must provide description of conditions seen, especially those that differ from the plan and specifications. Discrepancies with the plans and specifications are generally dealt with through change orders, construction change directives, or corrections to the work.
- For inspections prior to payment, it must confirm the estimated values of work completed and stored materials and itemize the percent of work complete for each task. Payments must be adjusted if there are any discrepancies.
- If environmental mitigation measures are required, the inspector must document compliance with such measures on the report. Noncompliance with mitigation measures should be reported promptly to the Loan Originator.
- The report must be signed by the inspector. The final inspection must also be signed by the borrower.
- Copies of all inspection reports (by the Agency inspector, the project architect, and any other inspectors — e.g., local, state, fire marshal) should all be kept in the construction file by the Agency.

#### 10.14 CHANGE ORDERS

Change orders are used when a contractor's mistake or unforeseen circumstances require a change in the contract's scope of work. Any construction changes that occur after a contract is executed and that affect project design, materials, costs, scope, or schedule, must be documented as a contract change order. The Owner, with the assistance of the Project Architect, shall obtain Agency concurrence in writing for all change orders prior to the performance of the work. The change order becomes a part of the construction contract. (Note, changes that are deemed minor and do not affect costs should be documented as construction change directives by the project architect.) *Form RD 1924-7 Contract Change Order* or its equivalent may be used.

- The change order should be supported by a cost breakdown. Additional profit and overhead in non-IOI cases must be explained. No additional profit or overhead is allowed in IOI cases.
- Generally, total changes to the work should not exceed 20 percent of the original contract cost. If changes exceed this threshold, an increase in performance and payment bonds will be necessary.
- If the change orders result in an increase in project costs, there are several ways to pay for these costs:
  - ◇ The borrower finds the funds elsewhere.



- ◇ Costs are reduced from another part of the project and a deductive change order is executed to document that change.
- ◇ In rare cases, the Agency may make a subsequent loan. Subsequent loans may only be made to complete, improve, repair, or make modifications to a project. Subsequent loan funds may not be used to reimburse an owner for additional contributions that were made to complete a project. In addition, no commitment for additional funds will be made by the Agency unless, and until, additional funds have actually been obligated. Finally, if a subsequent loan is made, the borrower equity and initial operating capital contribution requirements apply and the total amount of the combined loans may not exceed 95 percent of the appraised value, or total development cost, whichever is less.
- ◇ No increase in per unit development cost will be approved whether the circumstance causing the cost increase occurs before, during, or after the construction period, unless these conditions were unforeseen factors beyond the owner's control, design changes that were required by the Agency or local government, or changes in financing that were approved by the Agency. Any increase in cost must be approved by RHS in writing before the expense is incurred.
- ◇ Under no circumstances will a cost increase request be approved without concurrent agreement between RHS and the applicant/borrower as to how the cost increase will be funded. In most cases, this will mean that the owner will need to contribute additional funds.
- If the change orders result in a decrease in project costs:
  - ◇ Unused funds may be used to cover certain other eligible project costs if they were unknown to the borrower at the time the loan was approved.
  - ◇ Otherwise, the amount of the loan will be decreased and the funds deobligated.
- Change orders do not generally require preparation of *Form RD 1940-22, Environmental Checklist for Categorical Exclusions*, provided that the action will not alter the purpose, operation, location, or design of the project as originally approved.

## 10.15 PARTIAL PAYMENTS

The borrower and the Agency must take proper precautions to ensure that all payments made to the contractor are properly applied against bills for materials and labor procured under the contract.

*Form RD 1924-18, Partial Payment Estimate*, AIA Form G702, or other professionally recognized form that contains architect certification and approval, approval of the borrower, and conditional acceptance of Agency must be used. If the Agency form is not used, Agency concurrence language must be added to the form used.

The following procedures must be used in approving construction payments.

- Payment requests are submitted by the contractor to the owner. The request must include a statement showing total amount owed to date for material and labor procured under the contract. It may also include evidence showing that previous partial payments were applied properly. The payment requests should provide the same breakdown of construction costs as the final and approved cost estimate before construction began.
- The project architect and the borrower must review the request and confirm its accuracy before signing it and forwarding it to the Agency.
- The Agency will concur with the amount of partial payment based on its site inspection.
- The borrower should withhold a retainage of 10 percent until all work has been completed and accepted. When construction is determined to be substantially complete, an amount adequate to cover any remaining work items should be withheld from the contractor. This amount is normally included in the retainage. If the amount of remaining work is higher than the retainage, then the retainage must be adjusted upward accordingly. See paragraph 10.17 for a discussion of final payments at contract close-out.

#### **10.16 OBTAINING THE CHECK FOR MULTIPLE ADVANCES**

Once the Agency has approved the payment request, the Loan Servicer must order the check using AMAS. Note that the check request will take approximately five days from request to receipt.

When the check is received it is deposited in the supervised bank account. As work is completed, the Agency can release these funds to the borrower. If all work for that payment request is completed at the time of check receipt, the entire amount of the check can be released immediately to the borrower.

It is important to monitor the maximum debt limit (MDL) for the loan. The Loan Servicer should insure that the disbursed amount plus accrued interest does not exceed the MDL.

#### **10.17 CONTRACT CLOSE-OUT**

When work is complete, the contract must be closed out — all payments made and all claims released. However, prior to close-out, the Agency and the borrower must ensure that all work was performed according to the contract and that it meets acceptable standards.

##### **A. Final Inspections**

A final inspection must be conducted before the final payment to the contractor to ensure that all work is performed according to project plans and specifications and meets

all applicable codes and quality standards. If the project is receiving interim financing, the Agency loan must not be closed until this inspection is performed.

The project architect should coordinate the final inspection with all parties doing final inspections, including the Agency and the interim lender's fee inspector (if applicable), so that all inspectors may be present at the same time.

## **B. Final Payment**

Before the final payment can be made, the final payment documents as listed below must be executed:

- *Form RD 1924-9, Certificate of Contractor's Release*
- *Form RD 1924-10, Release by Claimants*
- *Form RD 1924-19, Builder's Warranty* or equivalent.
- Acceptance by responsible public authority. When local or state codes and ordinance require inspections, final acceptance by the local authority will be required prior to final inspection. A certificate of occupancy could be evidence of this inspection.
- Final acceptance by the project architect is also required.

If work cannot be completed due to weather or other extenuating circumstances (e.g., landscaping work that cannot be done during the winter), the Agency will withhold funds to ensure completion of the work. Usually, the amount withheld is 1.5 to 2 times the dollar value of the work completed. (This serves as an incentive to the contractor to come back and do the work.)

- Interim funds remaining because of early completion of construction will be returned. The leftover interest may be used for certain other eligible loan purposes critical to the completion of the project which were unknown to the applicant and contractor at the time the loan was approved.